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TAXING THE OUT-OF-STATE CORPORATION — A CONGRESSIONAL AWAKENING

by Stanley R. Huller

Without the benefit of congressional guidelines for nearly 170 years, the courts were compelled to weigh increasing state efforts to tax interstate commerce against the commands of the United States Constitution. A conflicting and confusing myriad of judicial decisions resulted, leaving both the multistate taxpayer and the taxing state without any cognizable tax standards.¹ In 1959 Congress for the first time exercised its powers to restrict state taxation of interstate business by enacting Public Law 86-272.² Presently, the problems incident to interstate taxation again beckon Congress. The purpose of this Comment is to reappraise these problems, survey the present status of the various state taxes, and evaluate the merits of a comprehensive interstate tax bill currently awaiting final congressional action.³

I. CONGRESS' ONE HUNDRED AND SEVENTY YEARS OF SILENCE

During the 170 years of congressional inaction prior to Public Law 86-272, the courts assumed the responsibility of establishing guidelines for state taxation of the interstate seller. Despite a laudable effort by the courts, however, a bewildering potpourri of legal decisions evolved from which no workable rules for interstate taxation could be extracted.⁴ The root of this judicial maze stretched back at least as far as the Articles of Confederation which, unlike the Constitution, contained no mutual tax concessions. Each state was therefore encouraged to exercise its power over commerce independently.⁵ The result was an interstate tax scheme based upon burden-

¹ See Dowling, *Introduction—State Taxation of Multistate Business*, 18 OHIO ST. L.J. 3 (1957).

² 73 Stat. 555 (1959), 15 U.S.C. § 381 (1964). The essential provisions of the Act are as follows:

101. Imposition of Net Income Tax—Minimum Standards

(a) No state, or political subdivision thereof, shall have power to impose, for any taxable year . . . a net income tax on income derived within such state by any person from interstate commerce if the only business activities within such state by or on behalf of such person . . . are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such state for sales of tangible personal property, which orders are sent outside the state for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the state; and

(2) the solicitation of orders by such person, or his representative, in such state in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

201. The Committee of the Judiciary of the House of Representatives and the Committee on Finance of the United States Senate, acting separately or jointly, or both, or any duly authorized subcommittees thereof, shall make full and complete studies of all matters pertaining to the taxation of Interstate Commerce by the States. . . .

202. The Committees shall report to their respective Houses the results of such studies, together with their proposals for legislation, on or before June 30, 1965.

³ H.R. 2158, 90th Cong., 2d Sess. (1968). The bill is presently awaiting senatorial action. The essential provisions of the bill as it now stands are attached hereto as an Appendix.

⁴ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 485 (1959) (Whittaker, J., dissenting).

⁵ Madison, *Preface to Debates in the Convention*, cited in HUNT & SCOTT, *DEBATES IN THE FEDERAL CONVENTION OF 1787* (1920).

some individual state taxes which often engendered mutual distrust and "angry regulations" among the states.⁶

With the adoption of the Constitution, the states surrendered portions of their respective sovereignty, including many powers over commerce. Although much confusion arose regarding the extent of the powers surrendered by the states,⁷ the Constitution clearly prohibited the states from individually levying duties on imports and exports⁸ and vested in Congress the power to regulate interstate commerce.⁹ From these constitutional concepts the Supreme Court fostered the principle that the commerce clause operated of its own volition to maintain freedom of trade among the states.¹⁰ Freedom of trade could not be maintained unless the states were prohibited from individually exercising their taxing powers beyond their respective borders.¹¹

*The Development of the Net Income Tax. Robbins v. Shelby County Taxing District*¹² was the first major decision affecting the development of interstate commerce. The case involved a license tax on transient salesmen whose only contact with the taxing state was the solicitation of business for out-of-state merchants. The Court held that "interstate commerce [could not] be taxed at all, even though the same amount of tax should be laid on [intrastate] commerce."¹³ Thus the Court completed the full circle, beginning with the Articles of Confederation and the proposition that each state was at liberty to tax its neighbor and ending with *Robbins*, holding that states were completely without the power to levy any tax on interstate commerce.¹⁴

Despite the temporary setback in *Robbins*, the states continued to probe the possibilities of interstate taxation. In 1891 the Supreme Court upheld a tax imposed by the state of Maine on an out-of-state corporation.¹⁵ The case, however, was readily distinguishable from *Robbins* because the taxpayer owned substantial properties in Maine and the tax was not a condition to commencement of interstate business, but was for the privilege of exercising the corporate franchise in the taxing state. Other cases have followed the distinction and sustained the tax where the incident thereof fell upon local instead of interstate business.¹⁶

⁶ *Id.*

⁷ "But the question respecting the extent of the powers actually granted, is perpetually arising, and will probably continue to arise, as long as our system shall exist." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 415, 421 (1819).

⁸ U.S. CONST. art. I, § 10.

⁹ *Id.* § 8.

¹⁰ *In re Rahrer*, 140 U.S. 545 (1891). See also *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 415, 436 (1819).

¹¹ See, e.g., *Memphis Steam Laundry Cleaners, Inc. v. Stone*, 342 U.S. 389, 395 (1952); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935).

¹² 120 U.S. 489 (1887).

¹³ *Id.* at 497.

¹⁴ *Robbins* was based on the commerce clause, the Court reasoning that the clause vested in Congress the power to regulate interstate commerce, and that since the states delegated this power to Congress by adopting the Constitution, they no longer retained it themselves.

¹⁵ *Maine v. Grand Trunk Ry.*, 142 U.S. 217 (1891).

¹⁶ *Ficklen v. Shelby County*, 145 U.S. 1 (1892); *Besser Co. v. Bureau of Revenue*, 74 N.M. 377, 394 P.2d 141 (1964).

The rationale underlying the early judicial decisions permitting interstate taxation was predicated upon the notion that an out-of-state merchant who exploits the local market should assume part of the state tax burden. In addition, the failure to tax the foreign vendor often discriminated against local merchants whose prices were higher because they were subject to domestic taxes.¹⁷ The first significant breakthrough in interstate taxation came in the area of sales and use taxes.¹⁸ Since the states ordinarily did not impose taxes upon goods sent out of state by the seller¹⁹ and since the vendor could escape the imposition of a sales or use tax in the purchasing state under early case law, the disadvantage to the local merchant was most blatant in this area.²⁰ In 1937 the Supreme Court finally acknowledged this imbalance and removed the barrier to sales and use taxes, upholding the power of the state to impose a use tax upon an out-of-state seller whose business was chiefly interstate.²¹

Bridging the resulting gap between the imposition of interstate sales and use taxes and the imposition of income taxes on the out-of-state vendor was more difficult because the income tax presented a much more complex problem. For example, the vendor's state normally taxed the income of the vendor, thereby presenting the possibility of multiple taxation.²² Furthermore, income tax schemes were hopelessly confused, being based upon a variety of standards having varying tax bases with intricate and inconsistent apportionment formulas.²³ The heart of the problem was examined in *Freeman v. Hewit*,²⁴ a case challenging the application of the Indiana gross income tax. The majority concluded that the tax was invalid because it was levied directly upon the proceeds of interstate commerce. Although voiding the tax, the case was significant in that it pointed the way toward a feasible method of interstate taxation based upon *net* income.²⁵

In the landmark decision of *Spector Motor Service, Inc. v. O'Connor*²⁶ the Supreme Court again pointed toward the *net* income tax, reiterating that a direct tax on interstate commerce could not stand even though a tax of equal magnitude levied on a "local incident" could be sustained. In *Spector*, a foreign trucking company maintained two stations in the taxing

¹⁷ *National Cash Register Co. v. Taylor*, 276 N.Y. 208, 11 N.E.2d 881 (1937), *cert. denied*, 303 U.S. 656 (1938).

¹⁸ See Lockhart, *The Sales Tax in Interstate Commerce*, 52 HARV. L. REV. 617 (1938).

¹⁹ TEX. TAX-GEN. ANN. art. 20.02 (Supp. 1967). "There is hereby imposed a limited sales tax at the rate of two per cent (2%) on the receipts from the sale at retail of all tangible personal property within the state."

²⁰ *National Cash Register Co. v. Taylor*, 276 N.Y. 208, 11 N.E.2d 881 (1937), *cert. denied*, 303 U.S. 656 (1938).

²¹ For a summary of these judicial decisions, see Hartman, *Sales Taxation in Interstate Commerce*, 9 VAND. L. REV. 138 (1956).

²² See CCH STATE TAX GUIDE ¶ 10-000 (1968); for a summary of state acts. See also CONTROLLERS OF AMERICA, A DECADE OF PROGRESS REGARDING MULTIPLE TAXATION ON INCOME FROM INTERSTATE COMMERCE (1960), for a summary of the multiple tax effects.

²³ *Id.*

²⁴ 329 U.S. 249 (1946).

²⁵ "These illustrative instances show that a seller state has various means of obtaining legitimate contributions to the costs of its government, without imposing a direct tax on interstate sales. While these permitted taxes may, in an ultimate sense, come out of interstate commerce, they are not, as would be a tax on gross receipts, a direct imposition on that very freedom of commercial flow which for more than a hundred and fifty years has been the ward of the commerce clause." *Id.* at 256.

²⁶ 340 U.S. 602 (1951).

state. The shipments were interstate and the proposed tax was levied on the franchise of the corporation for the privilege of doing business in that state. The tax was struck down because it was a direct "privilege" tax levied exclusively on interstate business.²⁷

It was not until 1959, just prior to Public Law 86-272, that the states discovered the indirect method of interstate taxation required by *Freeman and Spector*. In *Northwestern States Portland Cement Co. v. Minnesota* and its companion case, *Williams v. Stockham Valves & Fittings, Inc.*,²⁸ the Supreme Court finally upheld a state tax based upon the income of a foreign vendor. *Northwestern* involved a Minnesota tax specifically designed to reach corporations engaged exclusively in interstate commerce. The taxpayer maintained a permanent business establishment in Minnesota and solicited orders therein, but all orders were sent out of state for approval. In *Williams*, the taxpayer was a Delaware corporation which also maintained a sales office in the taxing state. Again all orders were sent to the corporation's home state for approval. Thus, in both cases the taxpayer's business in the taxing state was devoted solely to interstate commerce. Nevertheless, the Supreme Court upheld the tax in each instance, stating:

We conclude that net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus to support the same.²⁹

The tax was sustained as an indirect levy upon net income derived from the taxing state; it was not a gross receipts or "privilege" tax. The Court again declared that a tax levied upon the privilege of doing interstate business, although measured by net income, could not be sustained.³⁰

II. AN ATTEMPTED TAX SOLUTION: PUBLIC LAW 86-272

Northwestern-Stockham apparently left the states free to levy taxes upon the net income of a foreign vendor so long as the levy did not discriminate in favor of intrastate business and was properly confined to sellers whose activities within the state were substantial enough to satisfy due process demands. However, there remained significant problems of reconciling dissimilar state taxing statutes containing a multitude of tax rates and requirements, and determining a clear-cut standard for delineating the minimum contact necessary to sustain the imposition of the tax. These problems were directly responsible for the passage of Public Law 86-272.

The 1959 Act. Following *Northwestern-Stockham*, a Louisiana tax statute imposing a net income tax on an out-of-state seller whose sole contact with that state consisted of soliciting orders through non-resident salesmen was

²⁷ *Id.* at 608.

²⁸ 358 U.S. 450 (1959).

²⁹ *Id.* at 452.

³⁰ *Id.* at 458.

upheld by the Louisiana Supreme Court.³¹ The United States Supreme Court subsequently denied certiorari,³² apparently leaving the door open for state taxation based upon mere solicitation.³³ However, the United States Senate responded to the challenge and held a series of public hearings concerning the tax problem.³⁴ Shortly thereafter, Public Law 86-272 was enacted, prohibiting the levy of a net income tax upon any foreign corporation which limited its activities in the taxing state to soliciting orders for the purchase of tangible personal property.³⁵ Thus, for purposes of a net income tax, the minimum contact standard was drawn at the level of the in-state sales office.³⁶

In addition to the basic tax exemption provided by Public Law 86-272, there are several variations which appear to fall within the protective umbrella. First, the fact that a foreign vendor maintains resident (as opposed to non-resident) salesmen in the taxing state apparently does not place the vendor outside the protection of the Act.³⁷ Secondly, a vendor cannot be taxed solely on the basis of solicitation or other activities of an independent contractor.³⁸ Thirdly, a foreign vendor is not subject to a net income tax if the independent contractor *accepts* the solicited orders even though accepting orders by employees of a foreign vendor in the taxing state is apparently beyond the protection of the Act.³⁹

Limitations of Public Law 86-272. Public Law 86-272 provides a limited guideline for taxing the income of interstate vendors, but the Act is replete with problems. Certain activities of the foreign vendor are exempted from taxation, but there is no relief from the complexity and multiplicity provided for those vendors who fall outside the protection of the Act. These unfortunate enterprises must continue to evaluate the myriad of complex state apportionment formulas.

³¹ *Brown-Formen Distillers Corp. v. Collector of Revenue*, 234 La. 651, 101 So. 2d 70 (1958), *appeal dismissed, cert denied*, 359 U.S. 28 (1959). To further add to the confusion, the Supreme Court denied certiorari in another Louisiana case having a similar fact situation, thus leaving the impression that solicitation of orders alone might create a sufficient nexus to sustain the tax. *International Shoe Co. v. Fontenot*, 236 La. 279, 107 So. 2d 640, *cert. denied*, 359 U.S. 984 (1959).

³² 359 U.S. 28 (1959).

³³ There was a significant reaction from the business community, illustrated by the following statement: "The reaction to the decision was one of dismay in the business community and one of confusion in the area of state government." 114 CONG. REC. 4148 (daily ed. May 22, 1968).

³⁴ *Hearings, State Taxation of Interstate Commerce, Senate Select Committee on Small Business*, 86th Cong., 1st Sess. (1959).

³⁵ For the essential provisions of Public Law 86-272, see note 2 *supra*.

³⁶ Any uniform formula capable of completely eradicating the problem of varying state statutes was left for another day, but the Act indirectly relieved the problem by establishing a higher nexus level. In addition, Public Law 86-272 may have encouraged states to enact use taxes which were not protected by the Act, with the result that the complexity of state tax schemes are indirectly relieved, because a use tax is based upon the purchase price of goods, not upon a complex apportionment formula.

³⁷ See the statement by Senator Carlson (R. Kan.) in 105 CONG. REC. 16353 (1959): "Doe lives in Atlanta and under the laws of Georgia, is domiciled in, or a resident of, Georgia. This fact does not disqualify the company from exemptions from the Georgia net income tax provided the only business activities within Georgia by or on behalf of the company are those specified in section 101(a)."

³⁸ Act of Sept. 14, 1959, Pub. L. No. 86-272, 73 Stat. 555 (1959); 15 U.S.C. § 381(c) (1964).

³⁹ *Id.*

Another shortcoming of the Act is the scope of its protection. An interstate business consisting of solicitation of orders for intangibles is not protected under the Act, because the provisions of the Act are applicable only to sales of tangible personal property.⁴⁰ The Act also leaves open the question of what activities beyond mere solicitation will create a sufficient contact to sustain the tax. Does the fact that a salesman carries samples, accepts a down payment, or uses a display room in the taxing state come within the definition of "solicitation" and thus within the scope of the Act? Do these activities, separately or in conjunction, constitute a distinct business activity sufficient to justify a tax?

The most striking limitation of Public Law 86-272 is its potential discrimination against the small interstate vendor. A large multistate operation, which can absorb the cost of compliance with state laws and still realize substantial revenue gains, may readily limit its business activities so as to come within the Act; but the small interstate seller, for whom compliance is relatively expensive, may find that limiting business activities to the prescribed statutory minimum is not economically feasible.⁴¹ Finally, Public Law 86-272 provides only a limited regulation of interstate taxation because its provisions are applicable only to the imposition of net income taxes. As a result, the states have employed a host of other taxes, such as capital stock, franchise, sales and use, and gross receipts, in a continuing effort to tax interstate business.⁴²

III. ADDITIONAL STATE TAX BURDENS

Taxes Based upon Gross Receipts. Although gross receipts have been employed as a basis for interstate taxation,⁴³ such taxes are less desirable than a net income tax because they are inherently discriminatory.⁴⁴ A gross receipts tax is unrelated to the profits of the seller and therefore discriminates against those sellers having the lowest profit margins. Moreover, the gross receipts levy presents a greater possibility of multiple taxation.⁴⁵ Such taxes are typically unapportioned and can be levied at a given rate by each state and subdivision thereof despite the fact that the same transaction has been

⁴⁰ *Id.*

⁴¹ The cost of compliance for a small interstate vendor is prohibitive. "Some idea of the tax complexities confronting the interstate businessmen can be gained from the simple fact that a set of state tax laws along with the regulations and supplementary material as published by a major tax service is some 80 volumes thick and 22 feet in height. Add on the potential problems in dealing with literally thousands of local jurisdictions and it is small wonder that the present situation has been described as calling upon the taxpayer to comply with the uncompliant and the tax administrator to enforce the unenforceable." 114 CONG. REC. 4150 (daily ed. May 22, 1968).

⁴² See Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051 (1960).

⁴³ See, e.g., N.M. STAT. ch. 72, art. 15 (1953). See also *California Co. v. Colorado*, 141 Colo. 288, 300, 348 P.2d 382, 388 (1959), *appeal dismissed*, 364 U.S. 285 (1960), where the court stated that a gross receipts tax was but a variety of the income tax.

⁴⁴ H. GROVES, *FINANCING GOVERNMENT* 331 (5th ed. 1958). It is significant to note that gross receipts taxes are more appealing than net income taxes in at least one respect—they may be reliable revenue producers even in bad times when corporations have no net income.

⁴⁵ "The multiplicity of state taxes measured by gross receipts from interstate transactions would spell the destruction of interstate commerce and renew the barriers to interstate trade which it was the object of the Commerce Clause to remove." *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256 (1938). See also note 5 *supra*.

taxed in other jurisdictions.⁴⁶

Because of these discriminatory effects, the Supreme Court has consistently distinguished net income and gross receipts taxes.⁴⁷ Thus, in one case the Court declared that a gross receipts tax constituted a direct burden on interstate commerce and could not be sustained.⁴⁸ After applying this mechanical "direct burden" test for nearly fifty years, the Supreme Court adopted a new approach and upheld a New Mexico gross receipts tax because the particular tax did not result in multiple taxation.⁴⁹ In subsequent decisions the Court attempted to avoid "multiple taxation" by selecting a particular element of a business transaction which could be designated as an "intrastate incident" upon which the tax was levied.⁵⁰ An allocation system was thereby achieved with only the state in which the "intrastate incident" occurred having the power to tax gross receipts. But the "intrastate incident" was not always easily discernible; thus many courts discarded the approach and returned to the "direct burden" test.⁵¹

Because of this judicial vacillation, the current status of gross receipts taxation is not entirely clear. Many courts continue to permit the gross receipts levy where some justifiable attempt at apportionment is indicated.⁵² But a comprehensive system of apportioned gross receipts taxes is unlikely because it is improbable that an adequate apportionment formula can be defined to tax equitably the gross receipts of all types of businesses.⁵³ Moreover, a tax system based upon apportioned gross receipts is less likely to appeal to state interests because the interstate concern would pay only an apportioned tax while domestic businesses would pay the full tax.⁵⁴

Franchise Taxes. In addition to the taxes levied directly upon the income of out-of-state sellers, most states attempt to exact an additional tax for the privilege of conducting business in that state.⁵⁵ The "privilege tax" is usually measured by the net income of the vendor, but it differs from the net income tax in that its tax "subject" is the doing of business. On the other hand, the net income of the seller is both the measure and the subject of the net income tax. At first blush, the distinction between the two taxes

⁴⁶ See W. BEAMAN, *PAYING TAXES TO OTHER STATES* 9-2 (1963).

⁴⁷ See, e.g., *Freeman v. Hewit*, 329 U.S. 249 (1946); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938); *Philadelphia & So. S.S. Co. v. Pennsylvania*, 122 U.S. 326 (1887).

⁴⁸ *Philadelphia & So. S.S. Co. v. Pennsylvania*, 122 U.S. 326 (1887).

⁴⁹ *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938).

⁵⁰ See, e.g., *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951); *McGoldrick v. Bernwind-White Coal Mining Co.*, 322 U.S. 340 (1944). But see *Nippert v. Richmond*, 327 U.S. 416, 423 (1946) where the Court stated: "All interstate commerce takes place within the confines of the States and necessarily involves 'incidents' occurring within each State through which it passes . . . and there is no known limit to the human mind's capacity to carve out from what is an entire or integral economic process particular phases or incidents, label them as 'separate' and distinct' or 'local' and thus achieve its desired result."

⁵¹ *Freeman v. Hewit*, 329 U.S. 249 (1946); *Manila Trading & Supply Co. (Guam) v. Maddox*, 335 F.2d 152 (9th Cir. 1964).

⁵² *Green v. Western Union Tel. Co.*, 123 So. 2d 712 (Fla. 1960). See also Annot., 67 A.L.R.2d 1322 (1959).

⁵³ See Comment, *Federal Limitation on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 1024 (1962).

⁵⁴ W. BEAMAN, *PAYING TAXES TO OTHER STATES* 9-9 (1963).

⁵⁵ See, e.g., TENN. CODE ANN. § 67-2904 (1955). For the privilege of doing business in Tennessee, a franchise tax is imposed on apportioned capital stock, surplus, and undivided profits, at a specified rate.

seems trivial, but dicta in *Northwestern-Stockham* made it clear that pure interstate commerce may be subjected to a direct net income tax; however, a franchise tax, although measured by net income, is invalid if levied upon pure interstate commerce.⁵⁶

Because of this distinction, a direct net income tax can be levied on any out-of-state seller whose activities are not protected by Public Law 86-272, but a franchise tax cannot be levied upon the same seller absent at least some mixture of intrastate business. Thus a vendor who maintains a sales office in a foreign state (devoted solely to interstate business) can be compelled to pay a net income tax, but not a franchise tax. This distinction between the tax subject and the tax measure has met with vigorous disapproval,⁵⁷ and it remains a confusing clog in the wheel of interstate taxation.

Property Taxes. The typical property tax is an ad valorem tax, based upon the value of the taxpayer's property, computed by assigning a specified rate to the total value of the property.⁵⁸ Such a tax presents no problem to the single state taxpayer since both the property and the business activity are confined to the same state. But where the giant multistate taxpayer owns realty or personalty in several taxing jurisdictions, the problem becomes more complex. This complexity arises because the commerce clause apparently does not prohibit state taxation of tangible or intangible property located in the taxing state even though the property is owned by an interstate concern and used in interstate commerce.⁵⁹

Taxes levied upon tangible realty or personalty are less likely to create concern because double taxation is improbable. For realty, the situs of the property marks the taxing incident and any jurisdiction other than the situs is prohibited from levying a property tax on the realty.⁶⁰ For tangible personalty the situs is again the controlling factor.⁶¹ Thus, double taxation could occur only in the few instances where the property is temporarily absent from the situs.

In the case of intangible property, double taxation is a reality.⁶² Property taxes upon intangible property are ordinarily based upon the value of corporate franchises, securities, and promissory notes.⁶³ Such taxes create the problem of double taxation because they presently may be imposed

⁵⁶ "On the other hand, it has been established since 1918 that a net income tax on revenues derived from interstate commerce does not offend constitutional limitations upon state interference with such commerce." *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).

⁵⁷ "Many have called for judicial abolition of the *Spector* rule, and were disheartened by its reaffirmation in *Northwestern-Stockham*." W. BEAMAN, PAYING TAXES TO OTHER STATES 8-6 (1963). It has also been pointed out that some states have attempted to circumvent its impact by seizing upon the distinction and making statutory amendments to gain maximum revenues. Note, *State Taxation of Interstate Commerce: The Current Status*, 19 Sw. L.J. 170, 172 n.16 (1965). This distinction might also account for the great taxing shift to sales and use taxes. *Id.* See also note 36 *supra*.

⁵⁸ See W. BEAMAN, PAYING TAXES TO OTHER STATES 14-4 (1963).

⁵⁹ *Branniff Airways, Inc. v. Nebraska State Bd.*, 347 U.S. 590 (1954).

⁶⁰ *Hays v. Pacific Mail S.S. & Co.*, 58 U.S. (17 How.) 596 (1854).

⁶¹ *Fink v. Pennsylvania*, 268 U.S. 473 (1925).

⁶² See note 22 *supra*.

⁶³ See Comment, *supra* note 53, at 979 (1962).

in both the domicile state and the state where the taxpayer actually uses the property.⁶⁴ This form of double taxation has been specifically upheld by the United States Supreme Court on the basis that both states have sufficient contact with the taxpayer to sustain a property tax.⁶⁵ It has been suggested that a properly apportioned property tax on intangible property would prevent double taxation,⁶⁶ but presently the only satisfactory approach has been to apportion the tax on the income from such intangibles.⁶⁷

Sales and Use Taxes. To vitiate even the limited effect of Public Law 86-272, most states have enacted a sales tax accompanied by a compensating use tax,⁶⁸ thereby adding confusion to an already perplexing area. Both taxes are generally added to the cost of the goods so that the purchaser ultimately bears the tax burden. The sales tax is typically levied upon the gross receipts of a sale made within the jurisdiction of the taxing state. Delivery to the buyer within the state is usually a prerequisite to support the tax.⁶⁹ As an additional limitation, the vendor must have sufficient "contacts" with the taxing state to satisfy due process and commerce clause notions.⁷⁰

The degree of contact required is not altogether clear, but the Supreme Court has held that maintaining an office in the taxing state is sufficient.⁷¹ A continuous solicitation program employing salesmen in the taxing state may also be considered sufficient contact to support a sales tax.⁷² In *McLeod v. J. E. Dilworth Co.*,⁷³ however, the Supreme Court invalidated an Arkansas sales tax which was levied upon an out-of-state seller whose sole contact with Arkansas arose through the solicitation of orders in that state by the seller's traveling salesmen. The contract of sale was made outside Arkansas and the goods were delivered to the purchaser by common carrier. Whether or not the tax could have been sustained if the contract had been made in Arkansas or if the goods had been delivered by the seller was not answered by the Court. Cases subsequent to *McLeod* failed to clarify the minimum contact standard.

To combat the inadequacies of a naked sales tax, the states developed a compensating use tax which is levied upon the use of the property within the taxing state.⁷⁴ The combined sales-use tax scheme results in a sales tax on the out-of-state vendor measured by the price of his goods coupled with a use tax upon the in-state purchaser (though collected by the seller) in the same amount as the sales tax.⁷⁵ If the sales tax has been levied upon a pure

⁶⁴ *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936).

⁶⁵ *State Tax Comm'n v. Aldrich*, 316 U.S. 174 (1942).

⁶⁶ W. BEAMAN, *PAYING TAXES TO OTHER STATES* 14-8 (1963).

⁶⁷ See Saxe & Keigwin, *Taxation of Intangibles in Interstate Commerce*, 46 VA. L. REV. 1212 (1960).

⁶⁸ See, e.g., MD. ANN. CODE art. 81, § 324-400 (1957).

⁶⁹ This requirement may be demanded by the Constitution. *McGoldrick v. Bernwind-White Coal Mining Co.*, 309 U.S. 33, 58 (1940).

⁷⁰ *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937).

⁷¹ *McGoldrick v. Bernwind-White Coal Mining Co.*, 309 U.S. 33 (1940).

⁷² See W. BEAMAN, *PAYING TAXES TO OTHER STATES* 13-7 (1963).

⁷³ 322 U.S. 327 (1944).

⁷⁴ See, e.g., TEX. TAX-GEN. ANN. art. 20.02 (Supp. 1967).

⁷⁵ *Id.* The prescribed rate for Texas is two per cent. See note 19 *supra*.

interstate transaction and is thus offensive to constitutional principles, the use tax is required. If both taxes are applicable, statutes typically authorize the imposition of the sales tax to the exclusion of the use tax.⁷⁶ In short, the seller pays a sales tax, if not forbidden by the commerce clause; however, if the sales tax is prohibited, the seller collects a use tax and remits it to the taxing state.

The minimum contacts that an out-of-state seller must have with a taxing state to require the collection of a use tax seemingly should be the same as those contacts governing sales taxes. The courts, however, have required less contact in the case of a use tax, apparently reasoning that it is less of a burden to require an out-of-state vendor to act as a tax collector for the state than to bear a direct sales tax levy.⁷⁷ Accordingly, a use tax has been upheld where the seller merely owns property in the state,⁷⁸ conducts an out-of-state mail order business through a local retail outlet,⁷⁹ employs non-resident salesmen to conduct a program of continuous solicitation in a taxing state,⁸⁰ and solicits orders in the taxing state for a variety of firms.⁸¹ The Court only recently has defined the outer limit of the use tax by prohibiting the imposition of a use tax upon a mail order taxpayer who had no property or salesmen in the taxing state.⁸² Because of the lenient attitude of the courts toward sales and use tax systems, such taxing schemes have become an increasingly important source of revenue for the states.⁸³

At present, the confusing system of interstate taxation may be summarized as follows: A tax measured by unapportioned gross receipts or levied on the privilege of doing business may not be imposed by any state upon a taxpayer who does not conduct both interstate and intrastate businesses even though a sales office is maintained in the taxing state;⁸⁴ a tax which is apportioned and based upon the net income of the taxpayer may be imposed by any state in which the taxpayer maintains a sales office;⁸⁵ a tax levied upon the consumer and collected by the taxpayer can be imposed by any state in which the taxpayer solicits business through agents or employees;⁸⁶ a tax based upon the property of the taxpayer can be imposed only at the situs of the property if tangible,⁸⁷ or at both the domicile and the location of business activity if intangible.⁸⁸

⁷⁶ TEX. TAX-GEN. ANN. art. 20.04(J) (Supp. 1967).

⁷⁷ *McCleod v. J.E. Dilworth Co.*, 322 U.S. 327 (1944). In *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939), the Supreme Court upheld a use tax on the basis that requiring a seller to collect another's tax, as opposed to a direct tax imposition, is not taxation of interstate commerce. *But see* *McGoldrick v. Bernwind-Coal Mining Co.*, 309 U.S. 33 (1940), calling for the same nexus requirement for sales and use taxes.

⁷⁸ *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939).

⁷⁹ *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941).

⁸⁰ *International Shoe Co. v. Washington*, 326 U.S. 310 (1945); *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335 (1944).

⁸¹ *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). The Court upheld a use tax on a Georgia seller who was required to collect a Florida use tax on the basis of solicitation in Florida by independent brokers.

⁸² *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967).

⁸³ See Note, *supra* note 57, at 174.

⁸⁴ *Cheney Bros. v. Massachusetts*, 246 U.S. 147 (1918).

⁸⁵ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); 73 Stat. 555 (1959), 15 U.S.C. § 381 (1964).

⁸⁶ *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

⁸⁷ *Hays v. Pacific Mail S.S. & Co.*, 58 U.S. (17 How.) 596 (1854).

⁸⁸ *Braniff Airways, Inc. v. Nebraska State Bd.*, 347 U.S. 590 (1954).

Because of the bewildering status of interstate taxation created by the great variety of interstate tax devices, it is not surprising that Congress was pressured into action.⁸⁹ Yet Public Law 86-272 was merely a beginning, intended as an interim measure to preserve the status quo pending compliance with a mandate that the judiciary committee "make a full and complete study of all matters pertaining to taxation of interstate commerce by the states."⁹⁰

The committee report concluded that Congress must go beyond Public Law 86-272 and enact a comprehensive tax bill because present state tax laws are perplexing, difficult to meet, and beyond judicial control.⁹¹ As a result of this study, the Special Subcommittee on State Taxation of Interstate Commerce has promulgated a comprehensive tax bill in an effort to reconcile the competing interests of state revenue departments with the free flow of commerce.⁹²

IV. THE PROVISIONS OF H.R. 2158

Title I. The first title of H.R. 2158⁹³ provides that no interstate vendor who has less than \$1,000,000 in annual net federal income shall be subject to an income, gross receipts, or capital stock tax in any state in which the vendor does not maintain a "business location." A business location is defined as: (1) the owning or leasing of real estate in the taxing state, (2) the maintenance of a stock of goods for sale in the regular course of business, or (3) the presence of a local employee in the state whose activities consist of more than the mere solicitation of orders in the taxing state.

Title II. Under the provisions of title II, any small business subject to a tax in a foreign state under title I may elect to use an optional two-factor (payroll and property) formula to determine its tax liability.⁹⁴ Under this formula, no state will be permitted to tax a greater percentage of income or capital than the percentage arrived at by computing the proportion of tangible assets in the state and the wages of employees within that state to the taxpayer's total assets and wages.

⁸⁹ "The Court's suggestion to Congress (Northwestern-Stockham) that it legislate in the field, together with the alarm with which the business community quite understandably received the 1959 decisions, was sufficient to mobilize the 86th Congress, then in session, and Public Law 86-272 was promptly written into the statute book." 114 CONG. REC. 4143 (daily ed. May 22, 1968). See also note 33 *supra*.

⁹⁰ See note 2 *supra*.

⁹¹ Note, *supra* note 57, at 175.

⁹² H.R. 2158, 90th Cong., 2d Sess. (1968). See the Appendix for the pertinent provisions of the bill.

⁹³ See Appendix, tit. I, § 101(1). A corporation is excluded under title V if it has more than \$1,000,000 net federal income.

⁹⁴ The typical state tax apportionment formula is applied as follows: Total Tax Liability = (Rate of Tax) (Apportioned Net Income). Apportioned net income is equal to the product of the corporation's total net income and an apportionment ratio. The apportionment provides the point of deviation between the typical three-factor state formula and the two-factor formula featured in H.R. 2158. The three-factor formula consists of a fraction, the numerator of which is based upon the in-state property, in-state payroll, and in-state sales, and a denominator consisting of the seller's total property, payroll, and sales. The two-factor formula is applied identically except that the sales element is eliminated from both the numerator and the denominator. The desired result of either formula is to allocate to each state its fair share of tax revenues without compelling any corporation to pay more than its fair share of taxes.

Title III. Title III is designed to increase compliance with, and enforcement of, sales and use taxes.⁹⁵ In addition, this section reduces the possibility of multiple state taxation and establishes uniform guideposts for the collection of use taxes. Reduction in interstate sales taxation is accomplished by prohibiting the levy of a sales tax unless the taxing state is the destination of the interstate shipment. Unlike present tax laws, collection of a use tax may be required of the interstate seller only when he maintains a business location in the taxing state. A business location again includes owning or leasing property, maintaining a stock of goods, or employing agents to do more than merely solicit orders in the taxing state. In addition, a state may require the collection of a use tax from an out-of-state seller who regularly makes household deliveries in the taxing state. Each of these four jurisdictional standards is independent and only one need be met to sustain the tax.

Title III also provides for a reciprocal credit whereby each state must give credit for a prior sales or use tax imposed by a sister state.⁹⁶ This provision protects consumers who change their state of residence. Another provision of title III provides that if an interstate sale is made to a business purchaser within a state in which the purchaser is registered for sales tax purposes, the seller need not collect a tax. The purchaser would simply remit the tax directly to the taxing state. The last section of title III curtails present interstate taxation by local governments. This provision is designed to protect small companies from having to comply with the nearly 3,000 political subdivisions currently taxing interstate taxpayers, each according to its own standards.⁹⁷

Title IV. Title IV provides that no state or political subdivision thereof shall impose a tax on the income of any *individual* who earned or derived such income during any period while that person was not a resident of the taxing state, except to the extent such income was earned or derived from sources within the state. This provision is designed to bring interstate taxation of individuals in line with the other three titles of H.R. 2158 which define the limits of business taxation.⁹⁸

V. A CLOSER LOOK AT H.R. 2158

Since its inception, H.R. 2158 has generated enthusiastic criticism from numerous influential groups.⁹⁹ In fact, on the day before the bill was finally passed by the House of Representatives, a resolution of the 1968 Western Governors' Conference was introduced in the House urging the defeat of the proposed bill.¹⁰⁰ The attitude of the Governors, as well as that of the

⁹⁵ Non-compliance with present state tax laws has been found to be 97.5 per cent in the income tax area and 93.5 per cent in the sales and use tax area and has been characterized as "a despicable situation." 114 CONG. REC. 4137 (daily ed. May 23, 1968).

⁹⁶ See Appendix, tit. III, § 301(c). The reciprocal tax credit is presently employed in some state statutes, See, e.g., TEX. TAX-GEN. ANN. art. 7359a (Supp. 1967).

⁹⁷ 114 CONG. REC. 4139 (daily ed. May 22, 1968).

⁹⁸ See Appendix, tit. VI, § 601.

⁹⁹ Objections have been voiced by the National Legislative Congress, the National Association of Attorneys General, National Association of Tax Administrators, and the Council of State Governments. 114 CONG. REC. 4019 (daily ed. May 21, 1968).

¹⁰⁰ *Id.*

other dissenters, stems from several recurrent criticisms. First, it has been argued that the bill is "still another incursion by the Central Government against the states hitting them at the very roots of the federal system."¹⁰¹ Since raising revenue is essential to the function of any government, it is feared that if congressional limitation is imposed upon state taxing powers, "the states would indeed be nothing more than administrative subdivisions of a unitary governmental system."¹⁰² While this argument elicits an immediate sympathy for preserving "states rights" in a time when the federal government is seemingly everywhere, it simply ignores the fact that present state policies and judicial decisions are inadequate to deal with the problems of multistate taxation. It was precisely for this reason that the Supreme Court in *Northwestern-Stockham* invited Congress to act.¹⁰³

This argument also ignores the fact that H.R. 2158 represents significant compromises, many of which have been incorporated solely to protect the states' taxing powers.¹⁰⁴ For example, the bill originally called for a federal administrator to supervise the disputes which might arise. After continuous outcries of "states rights," the provision was deleted so that presently there is no procedure for federal intervention.¹⁰⁵

As a corollary to the first argument, critics of H.R. 2158 have suggested that a more appropriate means of effecting interstate tax regulations can be brought about by voluntary state adoption of a uniform tax compact.¹⁰⁶ This argument does merit at least theoretical appeal; in fact, sixteen states have adopted a "uniform act."¹⁰⁷ Nevertheless, the prospect of a self-adopted uniform interstate tax system is simply not a reality.¹⁰⁸

Many of the most strident criticisms stem from the fear that H.R. 2158 will somehow rob the state treasuries of needed revenues.¹⁰⁹ However, this criticism ignores nearly eight years of congressional investigation, which indicates that H.R. 2158 will not result in more than two-tenths of one per cent revenue gain or loss to any single state.¹¹⁰ Moreover, a loss of revenue probably would not occur for the simple reason that the states are not now collecting taxes from businesses which would receive protection from the Act. The record indicates that there is presently 97.5 per cent noncompliance in the sales and use tax area alone.¹¹¹ In addition, any revenue loss that might occur could be offset by the increased gain from new business gen-

¹⁰¹ 114 CONG. REC. 4143 (daily ed. May 22, 1968).

¹⁰² *Id.*

¹⁰³ "It has long been established doctrine that the Commerce Clause gives exclusive power to the Congress to regulate interstate commerce, and its failure to act on the subject in the area of state taxation nevertheless requires that interstate commerce shall be free from any direct restriction or imposition by the states." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).

¹⁰⁴ 114 CONG. REC. 4137 (daily ed. May 22, 1968).

¹⁰⁵ "They hollered 'states rights' and said they did not want to have Federal intervention. So what do we do in this bill? In this bill we concede that. There is no provision in this bill now for Federal intervention. Everything is left up to the states as the matter now stands." *Id.*

¹⁰⁶ 114 CONG. REC. 4019 (daily ed. May 21, 1968).

¹⁰⁷ 114 CONG. REC. 4144 (daily ed. May 22, 1968).

¹⁰⁸ *Id.* at 4143. See also Dane, *A Solution to the Problem of State Taxation of Interstate Commerce*, 12 VILL. L. REV. 507, 512 (1967) for a discussion of the states' application of a uniform tax act which is anything but uniform.

¹⁰⁹ 114 CONG. REC. 4142 (daily ed. May 22, 1968).

¹¹⁰ *Id.* at 4137.

¹¹¹ *Id.* at 4136. See also note 95 *supra*.

erated by the enactment of H.R. 2158, especially in view of the provisions designed to reduce the possibility of multiple taxation.¹¹²

Other critics have argued that the bill discriminates against domestic vendors.¹¹³ Supposedly, the bill would provide a tax haven for interstate sellers by permitting these sellers to send any number of salesmen into a foreign state without compelling them to contribute any revenue to the state.¹¹⁴ However, such critics overlook the fact that if all states impose some sort of corporate income tax, the interstate vendor will not escape liability because it will still be subject to a full income tax in the home state.¹¹⁵ In effect, the Act will concentrate tax revenue in the states where the vendor has a business location. Moreover, this argument carries less weight in view of the fact that out-of-state sellers are not now complying with state tax laws.¹¹⁶

Still others have criticized H.R. 2158 because it contains an optional two-factor formula for small businesses which are subject to the taxes of a foreign state.¹¹⁷ This provision goes beyond defining jurisdictional standards and has been described as "an unwarranted intrusion into the internal tax policy of the states."¹¹⁸ Although there is nothing inherently unfair about a three-factor formula (property, payroll, and sales), there are several justifications for the alternate two-factor formula based upon payroll and property.¹¹⁹ Since the completion of a sale in a state alone is insufficient to sustain tax jurisdiction,¹²⁰ it is only logical that including a sales factor in the apportionment scheme would "be undesirable since it would result in allocating income to states which had no jurisdiction to tax."¹²¹ In addition, the fact that the sales factor has been eliminated from the H.R. 2158 formula relieves the small company of the necessity of keeping detailed sales records of each interstate sale.¹²²

Some critics also have been concerned with the fact that H.R. 2158 restricts the ability of a state to require an interstate vendor to collect a use tax.¹²³ The bill does afford all out-of-state sellers more immunity from the use tax than is furnished by current judicial decisions.¹²⁴ In addition, the

¹¹² *Id.* at 4151.

¹¹³ Dane, *supra* note 108, at 521.

¹¹⁴ "The bill would also place California business at a distinct disadvantage to their out-of-state competitors, who could employ as many full-time salesmen as they wish to solicit orders in California without incurring sales tax liability or being required to collect the California use tax." 114 CONG. REC. 4151 (daily ed. May 22, 1968).

¹¹⁵ Dane, *supra* note 108, at 514.

¹¹⁶ See note 95 *supra*.

¹¹⁷ "Title II is an unwarranted intrusion into the internal tax policy of the states. Further, it will prove burdensome to those it intends to benefit, and it is poor public policy." 114 CONG. REC. 4144 (daily ed. May 22, 1968).

¹¹⁸ *Id.*

¹¹⁹ See note 94 *supra* for the fundamentals of apportionment using either a two- or three-factor formula.

¹²⁰ See Appendix, tit. I, § 101.

¹²¹ Dane, *supra* note 108, at 515.

¹²² Such a procedure would also eliminate the sellers' having to file fifty separate state tax returns.

¹²³ 114 CONG. REC. 4151 (daily ed. May 22, 1968). See also note 114 *supra*.

¹²⁴ Under *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), the Supreme Court has held that a use tax may be required where the taxpayer merely solicits orders in the taxing state. See note 81 *supra*. Under H.R. 2158 the seller would not be subject to the use tax requirement unless it maintained a "business location" in the taxing state. See Appendix, tit. I, § 101(2).

bill has vitiated the prevailing notion among the judiciary that a lower nexus level is required to compel a foreign vendor to act as a tax collector than is necessary to support the direct imposition of a tax upon that vendor.¹²⁵ In fact, out-of-state sellers are given broader protection in the use tax area because the exemption from the use tax applies to all interstate sellers without a "business location" in the taxing state and without regard for the amount of the taxpayer's net federal income.¹²⁶

The change of attitude in the use tax area arises from a realization that the collection burden now being placed on the out-of-state seller is much greater than was originally expected.¹²⁷ The use tax is intended to place the ultimate burden upon the consumer. Nevertheless, the seller remains accountable for all uncollected use taxes. In addition, the seller must, at its peril, determine whether or not the use tax is applicable to each sale under each state statute. Such a determination is especially difficult because each business has its own peculiarities and each state statute has its own requirements.¹²⁸ The result is that out-of-state sellers must either ignore state requirements, thereby incurring the wrath of state officials, or they must comply with such requirements and suffer the severe disadvantage of maintaining comprehensive state tax departments.¹²⁹ Moreover, any incidental advantage gained by exempting interstate sellers from the use tax when they have no "business location" in the state may be partially offset by the postage and handling fees concomitant to all out-of-state shipments.

Finally, states are presently prohibited by the Supreme Court decision in *Miller Brothers Co. v. Maryland*¹³⁰ from imposing a sales or use tax upon an interstate seller whose sole contact with the taxing state is the delivery of household goods therein. The decision has been vigorously criticized because it permits border sellers to exploit neighboring markets without contributing any tax to state revenues.¹³¹ H.R. 2158 eliminates this problem by permitting states to tax any interstate seller who makes such regular deliveries even though he has no "business location" in that state.¹³²

VI. POSSIBLE SENATORIAL MODIFICATIONS

The complexity of designing a comprehensive interstate tax scheme suitably balancing the interests of revenue seekers and business concerns suggests that H.R. 2158 may yet undergo substantial revisions.¹³³ The provision most likely to be changed is the optional two-factor formula which has received the most severe criticism and which is most expendable.¹³⁴ One suggested modification calls for a complete deletion of the option from the bill.¹³⁵ A more logical approach would be to require the use of the option in

¹²⁵ See note 77 *supra*, and accompanying text.

¹²⁶ See Appendix, tit I, § 101(2).

¹²⁷ Dane, *supra* note 108, at 524.

¹²⁸ *Id.* at 520.

¹²⁹ See note 41 *supra*.

¹³⁰ 347 U.S. 340 (1954).

¹³¹ 114 CONG. REC. 4136 (daily ed. May 22, 1968).

¹³² *Id.*

¹³³ At present the bill is under consideration in the Senate Finance Committee. See note 3 *supra*.

¹³⁴ See note 117 *supra*, and accompanying text.

¹³⁵ 114 CONG. REC. 4144 (daily ed. May 22, 1968).

all or none of the states. A more equitable tax would then be presented because a seller would be precluded from selecting only the state tax laws offering the most lenient requirements.¹³⁶ As a result, the individual state tax systems would not be impugned, and those critics who complain of the bill's unwarranted intrusion into the area of "states rights" would be appeased.¹³⁷

Another provision warranting possible modification is the arbitrary tax immunity ceiling whereby those firms with less than \$1,000,000 in annual net federal income are exempt from net income, capital stock, and franchise taxes. The immunity ceiling could be increased to include more out-of-state sellers within the protection of the bill. This would be justified in view of the relative ease with which today's businesses may expand in dollar volume. A decrease in the ceiling appears unlikely because a lower figure simply would not encompass enough interstate concerns. An alternative would be to eliminate completely the net federal income requirement. Such a change would be consistent with the sales and use tax provision which presently has no immunity ceiling; however, elimination of the ceiling would go beyond the admitted purpose of the act—to protect the small interstate seller upon whom the current burden of interstate taxation falls most heavily.¹³⁸ A more appropriate change would add the \$1,000,000 ceiling to the sales and use tax provisions, thereby achieving consistency and insuring that the small vendor would continue to be the principal recipient of the tax immunity.

Finally, the bill may be modified to provide special consideration for certain industries which are not presently adequately covered by any provision of the bill. For example, the moving industry continues to face double taxation because the bill does not restrict state ad valorem tax assessments against these carriers.¹³⁹ One instance of this injustice is illustrated by the assessment of over \$2,000 per year in ad valorem taxes by one neighboring state against a common carrier even though the company neither owned property nor maintained a station in the taxing state.¹⁴⁰ The mover was paying ad valorem taxes in his home state to the full extent and therefore was being subjected to double taxation.

The need for special tax relief in the moving industry is largely a result of the nature of the business.¹⁴¹ In order to provide a moving service, movers are necessarily exposed to the multiplicity of state taxes because of the need to cross state lines.¹⁴² However, appropriate legislation need not permit the movers to escape taxation. The Senate could prevent double taxation and still require the industry to "pay its way" by simply requiring a "business location" as a prerequisite to the imposition of ad valorem taxes by a state.

¹³⁶ Dane, *supra* note 108, at 528.

¹³⁷ *Id.*

¹³⁸ "The exclusion from the provisions of the act for companies with an average annual income of more than \$1 million, recognizes that the burden of multiple tax obligations falls most heavily upon small and medium-sized firms." 114 CONG. REC. 4149 (daily ed. May 22, 1968).

¹³⁹ See 114 CONG. REC. 4148-50, for a discussion of this particular industry and the failure of H.R. 2158 to provide adequate protection in this area.

¹⁴⁰ *Id.* at 4148.

¹⁴¹ *Id.*

¹⁴² *Id.*

VII. CONCLUSION

Taxation of the multistate concern inevitably involves reconciling the competing and conflicting interests of state revenue departments and the business community. The states are legitimately concerned with the problem of raising revenue to support their respective governments. On the other hand, the business community is concerned with tax legislation which reduces the high costs of doing business. H.R. 2158 represents a valiant attempt to weld these competing interests into a logical and just interstate tax scheme. The bill is a result of nearly eight years of intensive congressional study, and it goes far beyond its predecessor, Public Law 86-272, by establishing positive jurisdictional standards for state taxation of out-of-state sellers. These relatively simple guideposts will permit the courts to make rational decisions without having to fathom new law in a tortuous case by case method.

H.R. 2158 is not a perfect solution to the problems of interstate taxation. The two-factor apportionment formula is questionable; the inconsistency in having a \$1,000,000 annual net federal income limitation for capital stock, franchise, and net income taxes without a similar limitation for sales and use taxes is perhaps even more dubious; the inequities due to the lack of protection afforded certain special industries are only too apparent. Despite these limitations, H.R. 2158 strikes at the very heart of interstate tax problems. This bill stands as a tribute to Congress, and it is only fitting to conclude this discussion with an evaluation of the bill by Representative Willis, the man most responsible for its progress thus far:

All of our bills do not always hit exactly on the target. We are successful sometimes, and sometimes we are not. I am reminded . . . of the story they tell about Sir James Barry, the famous author of 'Peter Pan.' He was asked once whether his plays were always successful, and he said, 'Some of my plays are successful, and some are not,' and he said, 'some of my plays peter out, and some of them pan out.' So . . . I want to say that this bill, in general, as far as the answer to the vexatious problems of the taxpayers are concerned, mostly will pan out, and not peter out.¹⁴³

APPENDIX

H.R. 2158

TITLE I—JURISDICTION TO TAX

Sec. 101. Uniform Jurisdictional Standard.

No State or political subdivision thereof shall have power—

- (1) to impose a net income tax or capital stock tax on a corporation other than an excluded corporation unless the corporation has a business location in the State during the taxable year;
- (2) to require a person to collect a sales or use tax with respect to a sale of tangible personal property unless the person has a business location in the State or regularly makes household deliveries in the State; or
- (3) to impose a gross receipts tax with respect to a sale of tangible personal property unless the seller has a business location in the State.

¹⁴³ *Id.* at 4136.

A State or political subdivision shall have power to impose a corporate net income tax or capital stock tax, or a gross receipts tax with respect to a sale of tangible personal property, or to require seller collection of a sales or use tax with respect to a sale of tangible personal property, if it is not denied power to do so under the preceding sentence.

TITLE II—MAXIMUM PERCENTAGE OF INCOME OR CAPITAL ATTRIBUTABLE TO
TAXING JURISDICTION

Sec. 201. Optional Two-Factor Formula.

A State or a political subdivision thereof may not impose on a corporation with a business location in more than one State, other than an excluded corporation, a net income tax (or capital stock tax) measured by an amount of net income (or capital) in excess of the amount determined by multiplying the corporation's base by an apportionment fraction which is the average of the corporation's property factor and the corporation's payroll factor for the State for the taxable year. For this purpose the base to which the apportionment fraction is applied shall be the corporation's entire taxable income as determined under State law for that taxable year (or its entire capital as determined under State law for the valuation date at or after the close of that taxable year).

Sec. 202. Property Factor.

(a) *In General.*—A corporation's property factor for any State is a fraction, the numerator of which is the average value of the corporation's property located in that State and the denominator of which is the average value of all of the corporation's property located in any State.

(b) *Property Included.*—The corporation's property factor shall include all the real and tangible personal property which is owned by or leased to the corporation during the taxable year, except—

- (1) property which has been permanently retired from use, and
- (2) tangible personal property rented out by the corporation to another person for a term of one year or more.

(c) *Exclusion of Personalty from Denominator.*—The denominator of the corporation's property factor for all States and political subdivisions shall not include the value of any property located in a State in which the corporation has no business location.

(d) *Standards for Valuing Property in Property Factor.*—

(1) *Owned property.*—Property owned by the corporation shall be valued at its original cost.

(2) *Leased property.*—Property leased to the corporation shall be valued at eight times the gross rents payable by the corporation during the taxable year without any deduction for amounts received by the corporation from subrentals.

(e) *Averaging of Property Values.*—The average value of the corporation's property shall be determined by averaging values at the beginning and ending of the taxable year; except that values shall be averaged on a semi-annual, quarterly, or monthly basis if reasonably required to reflect properly the location of the corporation's property during the taxable year.

Sec. 203. Payroll Factor.

(a) *In General.*—A corporation's payroll factor for any State is a fraction, the numerator of which is the amount of wages paid by the corporation to employees located in that State and the denominator of which is the total amount of wages paid by the corporation to all employees located in any State.

(b) *Payroll Included.*—The corporation's payroll factor shall include all wages paid by the corporation during the taxable year to its employees, except that there shall be excluded from the factor any amount of wages paid to a retired employee.

(c) *Employees Not Located in Any State.*—If an employee is not located in any State, the wages paid to that employee shall not be included in either the

numerator or the denominator of the corporation's payroll factor for any State or political subdivision.

(d) *Definition of Wages.*—The term "wages" means wages as defined for purposes of Federal income tax withholding in section 3401(a) of the Internal Revenue Code of 1954, but without regard to paragraph (2) thereof.

Sec. 204. Zero Denominators.

If the denominator of either the property factor or the payroll factor is zero, then the other factor shall be used as the apportionment fraction for each State and political subdivision. If the denominators of both the property factor and the payroll factor are zero, then the apportionment fraction for the State where the corporation has its business location shall be 100 percent.

Sec. 205. Capital Account Taxes on Domestic Corporations.

The State in which a corporation is incorporated may impose a capital account tax on that corporation without division of capital, notwithstanding the jurisdictional standard and limitation on attribution otherwise imposed by this Act.

Sec. 206. Local Taxes.

The maximum percentage of net income (or capital) of a corporation attributable to a political subdivision for tax purposes shall be determined under this title in the same manner as though the political subdivision were a State; except that the denominators of the corporation's property factor and payroll factor shall be the denominators applicable to all States and political subdivisions. For this purpose the numerators of the corporation's property factor and payroll factor shall be determined by treating every reference to location in a State, except the references in sections 202(c) and 203(c), as a reference to location in the political subdivision.

TITLE III—SALES AND USE TAXES

Sec. 301. Reduction of Multiple Taxation.

(a) *Location of Sales.*—A State or political subdivision thereof may impose a sales tax or require a seller to collect a sales or use tax with respect to an interstate sale of tangible personal property only if the destination of the sale is—

(1) in that State, or

(2) in a State or political subdivision for which the tax is required to be collected.

(b) *Imposition of Use Tax.*—A State or political subdivision thereof may not impose a use tax with respect to tangible personal property of a person without a business location in the State or an individual without a dwelling place in the State; but nothing in this subsection shall affect the power of a State or political subdivision to impose a use tax if the destination of the sale is in the State and the seller has a business location in the State or regularly makes household deliveries in the State.

(c) *Credit for Prior Taxes.*—The amount of any use tax imposed with respect to tangible personal property shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the property on account of liability to another State or political subdivision thereof.

(d) *Refund.*—A person who pays a use tax imposed with respect to tangible personal property shall be entitled to a refund from the State or political subdivision thereof imposing the tax, up to the amount of the tax so paid, for any sales or use tax subsequently paid to the seller with respect to the property on account of liability to another State or political subdivision thereof.

(e) *Motor Vehicles and Motor Fuels.*—

(1) *Vehicles.*—Nothing in subsection (a) or (b) shall affect the power of a State or political subdivision thereof to impose or require the collection of a sales or use tax with respect to motor vehicles that are registered in the State.

(2) *Fuels.*—Nothing in this section shall affect the power of a State or polit-

ical subdivision thereof to impose or require the collection of a sales or use tax with respect to motor fuels consumed in the State.

Sec. 302. Exemption for Household Goods, Including Motor Vehicles, in the Case of Persons Who Establish Residence.

No State or political subdivision thereof may impose a sales tax, use tax, or other nonrecurring tax measured by cost or value with respect to household goods, including motor vehicles, brought into the State by a person who establishes residence in that State if the goods were acquired by that person thirty days or more before he establishes such residence.

Sec. 303. Treatment of Freight Charges with Respect to Interstate Sales.

Where the freight charges or other charges for transporting tangible personal property to the purchaser incidental to an interstate sale are not included in the price but are separately stated by the seller, no State or political subdivision may include such charges in the measure of a sales or use tax imposed with respect to the sale or use of the property.

Sec. 304. Liability of Sellers on Sales to Business Buyers.

No seller shall be liable for the collection or payment of a sales or use tax with respect to an interstate sale of tangible personal property if the purchaser of such property furnishes or has furnished to the seller—

(1) a registration number or other form of identification indicating that the purchaser is registered with the jurisdiction imposing the tax to collect or pay a sales or use tax imposed by that jurisdiction, or

(2) a certificate or other written form of evidence indicating the basis for exemption or the reason the seller is not required to pay or collect the tax.

No seller shall be required by a State or political subdivision thereof to classify interstate sales for sales tax accounting purposes according to geographic areas of the State in any manner other than to account for interstate sales with destinations in political subdivisions in which the seller has a business location or regularly makes household deliveries. Where in all geographic areas of a State sales taxes are imposed at the same rate on the same transactions, are administered by the State, and are otherwise applied uniformly so that a seller is not required to classify interstate sales according to geographic areas of the State in any manner whatsoever, such sales taxes whether imposed by the State or by political subdivisions shall be treated as State taxes for purposes of this Act.

TITLE IV—EVALUATION OF STATE PROGRESS

Sec. 401. Congressional Committees.

The Committee on the Judiciary of the House of Representatives and the Committee on Finance of the United States Senate, acting separately or jointly, or both, or any duly authorized subcommittees thereof, shall for four years following the enactment of this Act evaluate the progress which the several States and their political subdivisions are making in resolving the problems arising from State taxation of interstate commerce and if, after four years from the enactment of this Act, the States and their political subdivisions have not made substantial progress in resolving any such problem, shall propose such measures as are determined to be in the national interest.

TITLE V—DEFINITIONS AND MISCELLANEOUS PROVISIONS

. . . [Definitions omitted.]

Part B—Miscellaneous Provisions

Sec. 521. Permissible Franchise Taxes.

The fact that a tax to which this Act applies is imposed by a State or political subdivision thereof in the form of a franchise, privilege, or license tax shall not prevent the imposition of the tax on a person engaged exclusively in interstate commerce within the State; but such a tax may be enforced against a person engaged exclusively in interstate commerce within the State solely as a revenue

measure and not by ouster from the State or by criminal or other penalty for engaging in commerce within the State without permission from the State.

Sec. 522. Prohibition Against Geographical Discrimination.

(a) *In General.*—No provision of State law shall make any person liable for a greater amount of sales or use tax with respect to tangible personal property, or gross receipts tax with respect to tangible personal property, by virtue of the location of any occurrence in a State outside the taxing State, than the amount of the tax for which such person would otherwise be liable if such occurrence were within the State (subject to section 523). For purposes of this subsection, the term "occurrence" includes incorporation, qualification to do business, and the making of a tax payment, and includes an activity of the taxpayer or of a person (including an agency of a State or local government) receiving payments from or making payments to the taxpayer.

(b) *Computation of Tax Liability Under Discriminatory Laws.*—When any State law is in conflict with subsection (a), tax liability may be discharged in the manner which would be provided under State law if the occurrence in question were within the taxing State.

Sec. 523. Applicability of Act.

Nothing in section 101 or in any other provision of this Act shall be considered—

(1) to repeal Public Law 86-272 with respect to any person;

(2) to increase, decrease, or otherwise affect the power of any State or political subdivision to impose or assess a net income or capital stock tax with respect to an excluded corporation; or

(3) to give any State or political subdivision the power to impose a gross receipts tax with respect to a sale of tangible personal property if the seller would not be subject to the imposition of such a gross receipts tax without regard to the provisions of this Act.

Sec. 524. Prohibition Against Out-of-State Audit Charges.

No charge may be imposed by a State or political subdivision thereof to cover any part of the cost of conducting outside that State an audit for a tax to which this Act applies, including a net income or capital stock tax imposed on an excluded corporation.

Sec. 525. Liability With Respect to Unassessed Taxes.

(a) *Periods Ending Prior to Enactment Date.*—No State or political subdivision thereof shall have the power, after the date of the enactment of this Act, to assess against any person for any period ending on or before such date in or for which that person became liable for the tax involved—

(1) a corporate net income tax, capital stock tax (other than a capital account tax imposed on corporations incorporated in the State), or gross receipts tax with respect to tangible personal property, if during such period that person did not have a business location in the State; or

(2) a sales or use tax with respect to tangible personal property, if during such period that person was not registered in the State for the purpose of collecting tax, had no business location in the State, and did not regularly make household deliveries in the State.

(b) *Certain Prior Assessments and Collections.*—The provisions of subsection (a) shall not be construed—

(1) to invalidate the collection of a tax prior to the time assessment became barred under subsection (a), or

(2) to prohibit the collection of a tax at or after the time assessment became barred under subsection (a), if the tax was assessed prior to such time.

Sec. 526. Effective Dates.

(a) *Corporate Net Income Taxes and Capital Stock Taxes.*—Title II of this Act, and the provisions of section 101 and this title (except section 525) insofar as they relate to corporate net income taxes or capital stock taxes, shall apply in

the case of corporate net income taxes only with respect to taxable years ending after the date of the enactment of this Act, and in the case of capital stock taxes only with respect to taxes for which the valuation date is later than the close of the first taxable year ending after the date of the enactment of this Act. Any corporation shall be permitted to adjust its reporting period for net income tax purposes to the extent necessary to comply with this Act, effective for the first taxable year to which title II applies.

(b) *Other Provisions.*—The remaining provisions of this Act shall take effect on the date of the enactment of this Act.

TITLE VI—TAXATION OF INDIVIDUALS

Sec. 601.

(a) No State or political subdivision thereof shall have the power to impose for any taxable year ending after the date of the enactment of this Act an income tax on the income or to establish the rate of taxation on the income of any individual—

(1) which was earned or derived during any period while the individual was not domiciled in the State except to the extent the income was earned from sources within the State, or

(2) which was earned or derived from sources without the State during any period while the individual was domiciled in the State except to the extent the tax exceeds any income tax paid on such income to the State (or political subdivision) in which the income was earned or derived.

(b) For purposes of this Act—

(1) the term "State" shall include the District of Columbia, and

(2) "earned" means to acquire by labor, service, or performance and does not include the mere receipt of interest or dividend payments which are merely a return upon an investment and are not paid as a result of labor, service, or performance rendered.